R. STATUTE OF LIMITATIONS IN CHAPTER 42 TAX CASES

1. Introduction

The statute of limitations on assessment of Chapter 42 taxes was discussed in the 1981, 1982, and 1983 CPE textbooks. However, there may still be some confusion about this subject because of a change in position in the text and because the applicable Manual instructions (IRM 7(10)65.1, revised March 1, 1983) have not kept pace with the position changes and reflect the discarded viewpoint. This article covers the same ground as the 1981 through 1983 texts, except that it is limited to Chapter 42 taxes. It also incorporates an addendum to the 1983 text that was prepared after several of the 1983 CPE seminars had already been held.

2. Discussion

A. Why are the procedures for securing consents to extend the statute of limitations in Chapter 42 tax cases different from the procedures in income tax cases?

Special procedures are needed in Chapter 42 tax cases (other than those involving only section 4940 tax) because of the two unique provisions of section 6501(n)(1). The first of these is that a Form 990-PF or 5227 (but not a Form 4720) filed by a private foundation starts the running of the period of limitations on assessment of Chapter 42 tax not just for the foundation, but for all foundation managers and other disqualified persons. The tax for which the period of limitations starts is <u>any tax</u> attributable to an act (or failure to act) that occurred during the period covered by the foundation's return. "Any tax" means all first level taxes for the year of occurrence and for all future years that ultimately may fall fully or partially within the taxable period for the Chapter 42 violation involved. "Any tax" also includes the one-time second level tax that is imposed at the end of the taxable period. This, then, is the second unique rule of section 6501(n)(1), that a return for one year can start the statutory assessment period on tax liabilities that arise in one or more future years as well as for the current year.

B. Can a private foundation extend the statute for anyone else?

Although a foundation's return commences the running of the statutory assessment period for Chapter 42 taxes for both itself and all disqualified persons, the normal rules of section 6501(c)(4) apply to consents to extend the statute. Only the person liable for tax, or someone holding a proper power of attorney from that person, may extend the assessment period.

C. What years must be protected?

The statute must be protected for any year that a first or second level tax is imposed and the Service is considering an adjustment of the tax reported, if any. The 1982 CPE text discussed Chief Counsel's former position (G.C.M. 38862, dated May 21, 1982) that the self-dealing tax under section 4941 (and, by inference, the tax under sections 4944 and 4951) is not an annual tax but a one-time tax imposed entirely in the year in which the act occurred and, therefore, the statutory assessment period for only that one year had to be protected regardless of how many years fell within the taxable period. The 1983 text discussed a probable change in that position, a change that was made (G.C.M. 39066, dated November 25, 1983) after the 1983 text was printed. Chief Counsel now states that the first level section 4941 tax is an annual tax imposed for each year (of the disqualified person liable for tax) that falls fully or partially within the applicable taxable period for the act. Counsel does not believe that each year within the taxable period must be protected, but suggests that we do so as a precautionary measure in the absence of a court decision on this point. (Our position is simply that if a tax is imposed in a particular year, the statute of limitations for <u>that</u> year must be protected, not the statute for some other year.) Even in the case of section 4945, which imposes a one-time first level tax on the violation, it is necessary to protect the entire taxable period because the second level tax is imposed on the date the taxable period ends.

C. When are the various first level Chapter 42 taxes imposed? (Note: All of the following examples assume calendar year taxpayers.)

Section 4941 - (and 4951)	On the date the act of self-dealing occurs and on the <u>first</u> day of each succeeding taxable year that <u>begins</u> within the taxable period. In the words of the statute, the tax is imposed "for each year (or part thereof) in the taxpayer period". Example: If a self-dealing violation occurred 12/1/81 and was corrected 5/15/83 (or the taxable period ended on that date for some other reason), first level taxes would be due for 1981, 1982 and 1983.
Section 4942 -	On the <u>last</u> day of the year following the year in which the undistributed income arose and on the

last day of each succeeding taxable year that ends within the taxable period. Example: If a foundation's 1980 distributable amount was not distributed until 5/15/83, first level taxes would be due for 1981 and 1982. Since the foundation's 1983 taxable year does not end within the taxable period, no first level tax would be due for 1983.

Section 4943 - On the last day of the first taxable year in which the foundation has excess business holdings (BUT ONLY IF THAT TAXABLE YEAR ENDS WITHIN THE TAXABLE PERIOD) and on the last day of each succeeding taxable year that ends within the taxable period. Example: If a foundation purchased excess business holdings on 12/1/81 and and disposed of them on 5/15/83, first level taxes would be due for 1981 and 1982 but not for 1983 since that year does not end within the taxable period.

Section 4944 - On the date the jeopardizing investment is made and on the first day of each succeeding taxable year that begins within the taxable period. Example: If a jeopardizing investment was made on 12/1/81 and was disposed of on 5/15/83, first level taxes would be due for 1981, 1982 and 1983.

Section 4945 - (and 4952) On the date the taxable expenditure is made. Example: If a foundation made a taxable expenditure on 12/1/81 and corrected it on 5/15/83, the one-time first level tax would be due for 1981.

Section 4953 - Examination Division has jurisdiction over this Chapter 42 tax reportable on Form 6069, Return of Excise Tax on Excess Contributions to Black Lung Benefit Trust Under Section 4953 and Computation of Section 192 Deduction.

D. When are the second level Chapter 42 taxes imposed?

All second level taxes are imposed on the date the taxable period ends, if the taxable period ends by any means other than correction of the Chapter 42 violation involved.

E. What events trigger the end of the taxable period for Chapter 42 taxes?

The taxable period ends on the earliest of:

(1) correction of the Chapter 42 violation (in which case the second level tax would be eliminated);

(2) mailing of a notice of deficiency for the first level tax; or

(3) assessment of the first level tax.

Public Law 96-596 (enacted 12/24/80) changed the definition of "taxable period" by adding that third factor and proposed regulations under sections 4941 through 4945 have been drafted (but not published as of 1/2/84) to reflect the law change. The current draft of the regulations does not contain the provision in the current regulations that where a notice of deficiency is not sent either because the taxpayer filed a waiver of the restrictions on assessment and collection of the first level tax deficiency (Form 870-E) or because the taxpayer paid the deficiency, filing the waiver or paying the deficiency ends the taxable period. We have asked Counsel to add that provision to the draft regulations for the administrative convenience it provides the Service. (It can also result in a smaller first level tax liability for the taxpayer by ending the taxable period sooner than would otherwise occur.) For example, under current regulations if a self-dealer agrees that a section 4941 violation has occurred but is unwilling or unable to correct the violation by the time the EO specialist is ready to close the case, signing the waiver would stop the accrual of first level tax on the violation involved. If the current provision is not readopted this could cause an inconvenience in those cases in which the second level tax is based on the highest fair market value of certain property during the taxable period because the FMV of the property could increase before the end of the taxable period. Thus, it would be necessary to show the tax as a minimum amount that could increase before the end of the taxable period. If a notice of deficiency for the second level tax had to be prepared later by Appeals or EP/EO, it would be necessary for the particular Service function to determine whether the value of the property had increased between the time the examination report was prepared and the date the taxable period ended (by assessment of the first level tax or issuance of the notice of deficiency).

F. What form(s) should be used to extend the assessment period for Chapter 42 taxes?

Form 872, Consent to Extend the Time to Assess Tax, should be used in Chapter 42 tax cases. While Form 872-B, Consent to Extent the Time to Assess Miscellaneous Excise Taxes, might seem to be more appropriate because it refers to miscellaneous excise taxes (as Chapter 42 taxes are), that form is actually intended for those excise taxes that are not subject to the deficiency procedures and restrictions on assessment that apply to income, estate and gift taxes, and excise taxes under Chapters 41 through 45. That is why Form 872-B does not (but Form 872 does) explicitly incorporate the provisions of section 6503(a)(1), under which the issuance of a deficiency notice suspends the running of the statutory assessment period during the time that section 6213 prohibits the Service from making an assessment and for an additional 60 days.

However, based on the decision in Ramirez v. United States (38 AFTR 2d 76-5402), a properly completed Form 872-B could be used in Chapter 42 cases and section 6503(a)(1) would apply even though the form does not refer to that Code section or discuss its ramifications. The court said, "[U]pon the mailing of the notice of deficiency by the government, section 6503(a)(1), on its own, suspended the extended contractual period of limitation for the same 150 days and, without the aid of the automatic extension proviso in the agreement, the assessment would have been timely in any case." Still, it would be preferable to use Form 872 so the taxpayer will be informed of section 6503(a)(1) provisions and expressly agree with them than to use Form 872-B and rely on case law to resolve the question of whether or not that section applies.

G. How should Form 872 be prepared in Chapter 42 cases?

An addendum to the 1983 CPE text provided sample Forms 872. These were prepared in a way that avoided the problem of having to determine how many future years might ultimately fall within the taxable period for a particular Chapter 42 violation, and therefore, would have to be protected by consent. The sample forms which follow this text, were prepared for a continuing act of self-dealing involving a lease that spanned more than one taxable year of the self-dealer, a calendar year taxpayer. In that example, the lease was for a 5-year period and was entered into on 7/30/77. The transaction was disclosed on the foundation's calendar year 1977 Form 990-PF and on subsequent returns (all filed timely) while the lease was in effect.

Under section 6501(n)(1), the foundation's 1977 return commenced the running of the statutory assessment period for all section 4941 taxes (that is, for 1977 and all other years that would eventually fall within the taxable period) attributable to the 1977 act of self-dealing. The foundation's 1978 return similarly started the assessment period for the section 4941 taxes on the act deemed to have occurred on 1/1/78. Returns for 1979 and later years did the same for the acts deemed to have occurred in those years. Because each act was disclosed on the foundation's return for the appropriate year, section 6501(e)(3) provides for a 3-year assessment period for the taxes arising from each act. Absent such disclosure, the foundation's returns would still have started the assessment periods, but the length of each period would have been 6 years. In the case of a continuing act of self-dealing, it would be possible that a 3-year assessment period would apply to one or more of the acts that were adequately disclosed by the foundation and a 6-year assessment period would apply to one or more of the remaining acts that were not disclosed.

The first sample consent form (A) that follows relates to the act of self-dealing that occurred on 7/30/77. Using the words "years that are fully or partially within the taxable period" will include all years for which a first-level section 4941 tax is imposed on the act and the one year the second level tax is imposed. This is true even through the taxable period might not end until some future year that would not be determinable at the time the consent is secured.

The second consent form (B) relates to the act deemed to have occurred on 1/1/78. The unextended assessment period for this act is 3 years and would expire one year after the end of the assessment period for the 7/30/77 act because it was disclosed on the foundation's 1978 return, filed one year after the return was filed that disclosed the 1977 act. Consent form (A) does not protect the assessment period for the taxes on the act deemed to have occurred on 1/1/78.

In the case of multiple Chapter 42 violations (such as taxable expenditures) within the same taxable year, it would not be practical to specify the date each taxable period began, as on sample consent forms (A) and (B). Consent form (C) would be appropriate in such instances.

[Appendices A-C not shown here]